KVT-13

STANFORD INTERNATIONAL BANK LIMITED

AUDIT REPORT No. 07-16

4th QUARTER 2006

<u>Distribution</u>
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James Davis
Audit Committee
Juan Rodriguez Tolentino
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INTERNAL AUDIT DEPARTMENT – STANFORD FINANCIAL GROUP

STANFORD INTERNATIONAL BANK LIMITED

AUDIT REPORT NO. 07-16

TABLE OF CONTENTS

Internal Audit Department – Stanford Financial Group
Audit Report of Stanford International Bank Limited

Executive Summary
(Report No. 07-16)

Introduction

In April 2007, the Internal Audit Department (the Department) began a scheduled audit of the Stanford International Bank Limited (The Bank). The Bank was last audited in November 2006.

The Company:

Since 1985 Stanford International Bank Ltd. has provided international private banking services to high-net-worth individuals around the globe. The Bank is domiciled in Antigua, a low tax jurisdiction and a sovereign nation and member of the British Commonwealth. Antigua and Barbuda maintains strict laws protecting private financial information. The Bank focuses on a very select client profile and offers a very limited product line geared solely to high-net-worth individuals and families.

Financial Highlights

The Banks Operating Profit was US$ 11.5 million for the fourth quarter of 2006 compared to US$ 19.7 million for the fourth quarter of 2005. Total assets were US$ 5,336 million as of December 31, 2006 and US$ 4,059 million as December 31, 2005.

Audit Objective

The audit objective was to perform a review of the financial statements for the period under audit to assure the financial statements are presented fairly in all material respects and to gain assurance that the internal controls are functioning adequately.

Audit Scope

Audit procedures consisted of a review and detailed testing of various accounts on the balance sheet and income statement including an analytical review of the income statement. We verified the balances in the published financial statements and tested the internal controls using interviews, questionnaires, random sampling and physical verification. On this occasion, we did not review supporting documentation for the investments and investment income accounts.

Conclusion

It is our opinion that the balances in the financial statements as of December 31, 2006 present fairly the results of the operations and the position of the company in all material respects. Based on the results of our audit, which included no major finding, our opinion is that overall the internal controls we tested at the Stanford International Bank Ltd. are functioning adequately.

Major Findings

- **Bank Reconciliations**
  Bank accounts reconciliations should be prepared and reviewed by separate individuals indicating the date of when these tasks were performed.

- **Fixed Assets**
  Fixed assets acquired in 2006 did not have the required identification tag or bar code.

A. PURCHASING AND ACCOUNTS PAYABLE FUNCTION

1. Bank Reconciliations

Observation: Although the month-end bank reconciliations are performed on a timely basis, they are not approved, signed, and dated by another reviewer.

The Stanford Group of Companies Global Accounting Policies and Procedures require that policies and procedures within the organization should be designed to include segregation of duties as one of its main internal control objectives. Bank accounts reconciliations should be prepared and reviewed by separate individuals indicating the date of when these tasks were performed.

Recommendation: We recommend that for the month-end bank reconciliation process, Bank management ensure adherence to the Stanford Group of Companies Global Accounting Policies and Procedures by having someone independent of the reconciler review, sign and date the reconciliation.

B. FIXED ASSETS

1. Physical Control of Fixed Assets

Observation: We examined copies of the invoices of all 2006 purchases of fixed assets. We found that all 2006 fixed assets purchased were accounted properly and depreciation charges were in agreement with current fixed assets policy. During our test work of this process, we learned that all fixed assets acquired in 2006 did not have their identification tag or bar code. The assignment of identification tag or bar code is an important and essential physical control feature for fixed assets of any category.

Recommendation: We recommend that Bank management ensure the enforcement of the physical control procedures as outlined in the Stanford Group of Companies Global Accounting Policies and Procedures dated June 2005 that require all fixed assets be identified by an identification tag number or a bar code.

KVT-14

STANFORD FINANCIAL GROUP **CONFIDENTIAL**

Internal Audit Department –July 17, 2006

Audit of SIBL 1Q06

Distribution:
R. Allen Stanford
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Audit Committee
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Bhanoo Persaud

Audit Team:
Fran Casey, Jr.,
Richard Casas
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EXECUTIVE SUMMARY

We performed the first quarter 2006 audit of Stanford International Bank Limited from April 24 through May 3, 2006. Our audit included random testing of the internal controls in place, and verification of the balances and their related supporting documents as presented on the financial statements.

We encountered no difficulty and no misstatements on the working papers or supporting documents during our quarterly analysis. Any other relevant information or questionable items were resolved on site before completion of the fieldwork.

We did not review supporting documentation for the investments, investment income, or management fees paid.

Following are the areas that should be improved as a result of our audit:

CASH AND CASH EQUIVALENTS

1. The Bank maintains interest bearing accounts and short term certificates of deposits with various financial institutions. We observed that the bank does not accrue the interest earned for these accounts. This interest income is booked on a cash basis when received at maturity. This practice led to an understatement of Revenue and Net Income by $646,161 for the quarter ending March 31, 2005.

2. The Bank calculates their monthly cash position for foreign currency bank accounts in Canadian Dollars, British Pounds, Euros, and Eastern Caribbean Dollars using currency exchange rates received in the morning of the second to last working day of the month from the Memphis office. We confirmed with Memphis that these currency exchange rates are intraday spot rates not closing numbers. The impact of this practice resulted in the understatement of $300,000 in cash for the quarter ending March 31, 2006.

3. We observed that the Bank does not disclose gain (or loss) from foreign exchange for bank accounts in foreign currencies as a result of exchange rate fluctuations from month to month in a separate account. This profit (loss) is included as other income (expense) on the income statement.

4. We reviewed the bank account reconciliations and observed various outstanding items older than 60 days.

ACCOUNTS RECEIVABLE

5. The aging of the intercompany accounts receivable shows that all of the receivables from related companies exceed 12 months.

ACCOUNTS PAYABLE

6. The account payable vouchers are not signed or initialed by the preparer of the voucher.

7. Bank policy states that: "All checks require at least two signatures with the exception of the single signatory bank account. At least one of the dual signatures should be someone independent from the person who approves the transaction for payment." With the exception of the single signatory account, we observed that the accounting manager signs checks for items which he has also approved for payment.

OPERATING INCOME – SERVICE FEES AND COMMISSIONS

8. In the first quarter of 2006 the Bank paid $48,863,410 in the form of management fees, service fees, and commissions to Stanford Financial Group Company (SFGC), Stanford Group Company (SGC), Stanford Trust Company Limited (STCL), and Stanford Group Antigua Limited (SGAL). The Bank did not provide the auditors with copies of the agreements that SIBL had with these companies in order to verify that the management fees, service fees and commissions paid were in accordance with the terms of the agreements.

EXPENSES

9. We reviewed the rent expense and observed that the Bank makes payments to Stanford Development Company Limited (SDCL) for the use of the Bank premises. The Bank did not have copies of all of the leases for which they were making payments.

For a more detailed explanation of each issue please refer to the attached audit report.

To ensure all above issues are addressed, we require a report of corrective action. Such report should be addressed to our attention not later than August 11, 2006.

We appreciate the cooperation received from management that facilitated our review.

SCOPE AND METHODOLOGY

Our audit focused on evaluating the effectiveness of the internal controls of the financial reporting process, as well as the general internal controls for the financial operations of the Bank. Our review and testing was performed as per the trial balance dated March 31st, 2006.

The audit process consisted of verifying account balances and their supporting documents as presented on the balance sheet as of March 31st, 2006, and tracing them from the trial balance to the subledgers and their related supporting documents. Income statement accounts were traced to the trial balance and subledgers. Supporting documents for revenue and expense accounts were randomly verified.

During the audit process we reviewed and performed the following steps:

1. Tested the internal controls of the financial reporting process in place.
2. Reviewed balance sheet and income statement account balances in ledgers and subledgers including testing of revenue and expense accounts.
3. Reviewed bank reconciliations, deposits in transit, wire transfers and outstanding checks for all accounts as of March 31st, 2006.
4. Reviewed the methodology for calculating depreciation of fixed assets as per the specifications on the calculation sheet.
5. Reviewed proper codification of accounts.
6. Reviewed intercompany billing transactions, supporting documents and current balances on account.
7. Reviewed accounts receivable and accounts payable aging schedules as of March 31st, 2006.
8. Reviewed at random fixed assets allocations and capitalization entries.
9. Reviewed all working papers issued by the SIBL accounting department.

ATTACHMENTS

SUPPORTING DOCUMENTS

*** Source – SIBL Accounting Department**

Stanford Financial Group

To: Stanford Financial Group Company
Attn: Board of Directors
Gil Lopez

To: Stanford International Bank Limited
Attn: Audit Committee
Juan Rodriguez Tolentino
Cc: Miguel Pacheco
Bhanoo Persaud
Pedro Rodriguez

From: Internal Audit Department

Date: July 17, 2006

Subject: Stanford International Bank Limited – 1st Quarter, 2006 Review

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Following are our comments related to the 1st Quarter Review of the Financial Statements of Stanford International Bank Ltd., as of March 31st, 2006.

The analysis and its findings were performed and evaluated as per the balance sheet and income statement presented by the accounting department of SIBL at location. This evaluation was made in accordance with standard accounting practices and regulations.

All amounts are expressed in US$.

Please see attachment AA2

ASSETS

CASH ACCOUNTS

Total Balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 256,474,934	$ 302,679,526

General ledgers, related subledgers, bank statements, account reconciliations, letters of credit, transactions, currency rates, and adjustments were reviewed as per the balances presented. The review performed covered all account balances and did not include day-to-day account operations from January 1st to March 31st, 2005. Deposits in transit and outstanding checks were also verified and reviewed.

Cash increased in the amount of $46,205,000, up 18% to $ 302,679,526 for the quarter ending March 31, 2006.

Please see attachment AT.1

1. Observation

The Bank maintains interest bearing accounts and short term certificates of deposits with various financial institutions. We observed that the bank does not accrue the interest earned. Interest income is booked on a cash basis when received at the maturity date.

We observed that interest income from interest bearing accounts and short term certificates of deposit totaling $995,485 earned in the third and fourth quarters of 2005 was not booked until it was received in the second quarter 2006. Also, the interest income earned in the first quarter of 2006 of $646,161 was not registered until the second quarter.

As a result of not accruing interest income during the period in which it was earned the Bank understated Revenue and Net Income by $995,485 for year ending 2005 and by $646,161 for the first quarter of 2006.

Recommendation

We recommend that the Bank accrue interest income earned on a monthly basis for interest bearing accounts and certificates of deposit to comply with GAAP and avoid understating the Revenue of the Bank. World wide accounting policy requires accurate financial reporting in order to prepare meaningful financial statements.

2. Observation

The Bank calculates their monthly cash position for foreign currency bank accounts in Canadian Dollars, British Pounds, Euros, and Eastern Caribbean Dollars using currency exchange rates received in the morning of the second to last working day of the month from the Memphis office. We confirmed with Memphis that these currency exchange rates are intraday spot rates not closing numbers. SFG Accounting stated that currency exchange rates used to calculate the monthly cash position should be the closing currency exchange rate from the last working day of the month. The impact of this practice resulted in the understatement of $300,000 in cash for the quarter ending March 31, 2006.

Recommendation

We recommend that the Bank use the closing currency exchange rates for the last day of the month to calculate their cash position in foreign currencies. World wide accounting policy requires accurate financial reporting in order to prepare meaningful financial statements.

3. Observation

The Bank does not disclose gain (loss) from foreign exchange for bank accounts in foreign currencies. This is included in other income (expense) on the income statement. We have calculated a gain of $1,784,316 for the quarter ending March 31, 2006 for cash balances held in foreign currency cash accounts resulting in a reclassification among the two income statement accounts.

Recommendation

We recommend that the Bank disclose the gain (loss) from foreign exchange in a separate account for better disclosure on the financial statements. This will allow the Bank to better monitor the foreign currency exposure.

4. Observation

The bank account reconciliations show outstanding items older than 60 days in payroll account number 1000-1030-4000. There are checks from November 2005 through January 2006 for a total amount of $1,850 that has not been posted by the Bank. In the same account, check number 6599 for the pay period dated March 15, 2006 was not identified.

On account number 1000-1040-2000 there are two wire transfers dated January 25, 2006 in the total amount of $13,020 that have not been recorded by the Bank.

Recommendation

We recommend that the Bank clear any outstanding items older than 30 days on the bank account reconciliations. All transactions should be recorded accurately and timely in accordance with company policy.

INVESTMENT PORTFOLIO

Total Balance on account	Dec 31st, 2005	Mar 31st, 2006
	$3,754,765,105	$3,975,142,810

The investment portfolio increased by $220,377,705 to $3,975,142,810 during the first quarter. This was an increase of 6%. The audit process for the investment portfolio solely consisted of tracing the account balances from the trial balance to the account balances as presented on the balance sheet as of March 31, 2006.

Please see attachment AA.2, AA.3

ADVANCES TO CUSTOMERS AND OTHER ACCOUNTS

Total Balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 43,274,461	$ 53,577,785
Account details:		
Loans & Notes Receivable	$ 36,558,681	$ 46,699,573
Prepaid Items	4,798,202	4,775,398
Accruals	1,890,167	2,158,766
Accounts Receivable	28,614	28,194
Position account		(1)
System Suspense Account	(1,204)	(84,146)
Total	$ 43,274,460	$ 53,577,785

Advances to customers and other accounts increased 23.51% during the first quarter of 2006. This was primarily due to the increase in Loans and Notes Receivable. The Loans and Notes Receivable are 100% secured.

Please see attachment AT.2

5. Observation

All of the transactions included as accounts receivable from related companies are greater than 12 months old are as follows:

Related Company	Amount	Most Recent Invoice
Stanford International Bank Panama	$ 23,306	04/30/2004
Caribbean Star Airline	3,513	05/21/2004
Stanford Development Company	735	07/28/2004
Stanford International Bank Panama	483	10/20/2003
Sun Printing	205	08/23/2004
Stanford Group Antigua	(48)	
Total	$ 28,194	

Recommendation

These amounts should be confirmed as valid claims on the respective entities then collected. Disputed items should be written off. Though immaterial in this case, the bank should establish the practice of regularly reviewing the reliability of all accounts.

FIXED ASSETS

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	4,600,009	4,120,401
Fixed assets allocations are:		
Building	$ 4,893,621	$ 4,893,621
Computer Software	2,469,516	2,498,801
Furniture & Fixtures	948,638	958,751
Land	573,293	573,293
Machinery & Equipment	325,366	374,967
Work in Progress	215,118	171,842
Vehicles	546,166	121,930
Artwork & Accessories	72,620	62,507
Leasehold Improvement	61,537	61,540
Allowance for Depreciation	(5,506,591)	(5,425,009)
Total Fixed Assets	4,600,009	4,120,401

Verified fixed asset accounts and the depreciation calculation schedule. The Fixed Assets decreased by $307,767 during the first quarter of 2006. This was primarily due to the quarterly depreciation and the disposition of motor vehicles.

Please see attachment AA.2, AA.3

LIABILITIES

CUSTOMER DEPOSITS

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 3,763,011,041	$ 4,036,777,141

Please see attachments AA.2, AA.3

Customer deposits increased by $273,766,100 during the first quarter 2006 to $4,036,777,141. This was an increase of 7.28% for the period ending March 31, 2006.

ACCOUNTS PAYABLE AND ACCRUALS

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 13,648,916	$ 12,046,262.86
Account details:		
Accounts Payable	$ 11,413,698	$ 10,660,500
Reconciled Items	1,726,482	1,492,395
Suspense	52,477	42,988
Accrued Interest	755,226	18,720
Adjustment		54
Benefits Payable	144	0
Checks pending issuance	(299,110)	(168,394)
Total	$13,648,916.40	$12,046,262.86

Accounts payable and accruals decreased $1,602,654, or 11.74% during the quarter.

Please see attachments AT.4

6. Observation

When reviewing Bank expenses we observed that supporting documents for payments include an accounts payable voucher. The vouchers are not signed or initialed by the preparer or approver. In order to see evidence that the vouchers were prepared by someone independent from the person that approved the payment the junior accountants should initial or sign the vouchers which they prepare.

Recommendation

We recommend that Bank management require the junior accountants to sign or initial the accounts payable vouchers that they prepare.

SHAREHOLDER'S EQUITY

SHAREHOLDER'S EQUITY

Shareholder's Equity	Dec 31st, 2005	Mar 31st, 2006
	$ 282,453,830	$ 286,868,961
Account details:		
Capitol	$ 10,000,000	$ 10,000,000
Paid-In-Capitol	103,500,000	103,500,000
Retained Earnings	133,042,596	168,953,830
Current Net Income	35,911,234	4,415,132
	$282,453,830	$ 286,868,961

The variance of the account represents the profit for the first quarter of 2006, $ 4,415,132.

Please see attachments AA.2, AA.3

INCOME STATEMENT

INTEREST INCOME

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 22,964,032	$ 7,571,581
Account details:		
Interest & Non Interest Income	$ 131,978,495	$121,969,382
Less Interest Paid	(62,985,512)	(65,534,391)
Less Service Fees & Commissions	(46,028,952)	(48,863,410)
Net Interest & Non Interest Income	$ 22,964,032	$ 7,571,581

We verified the details of the income statement as per the financial statements as of March 31st, 2006 against the trial balance, subledgers, and supporting documentation. Interest and Non Interest Income fell by $10,009,113 during the period from the previous quarter. This was a decrease of 7.58% from period ending December 31, 2005.

Interest Paid to Customers and Service Fees and Commissions both increased during the period, 4.05% and 5.73% respectively. After deductions for Interest Paid to Customers and Management Fees, Service Fees, and Commissions, Net Interest and Non Interest Income before Operating Expenses fell to $7,571,581 from $22,964,032 for the previous quarter, a decline of 66.76%. .

Please see attachments AA.2, AA.4

7. Observation

A significant cost of sales are the Management Fees, Service Fees, and Commissions, that the Bank pays to Stanford Financial Group Company (SFGC), Stanford Group Company (SGC), Stanford Trust Company Limited (STCL), and Stanford Group Antigua Limited (SGAL). For the first quarter of 2006 SIBL made the following payments:

SFGC	$ 22,024,652
SGC	$ 21,689,385
STC	$ 2,916,163
SGA	$ 2,185,745
Total	$ 48,815,945

We requested from the Bank copies of the agreements between SIBL and the companies to which SIBL pays Management Fees, Service Fees, or Commissions so that we could verify that the amounts paid were in accordance with the terms of the agreements. As a result of not providing the agreements we were not able to verify that the Management Fees, Service Fees and Commissions paid in accordance with the terms of the agreements. Permission was to be requested from the Board of Directors.

Recommendation

We recommend that the Bank management request confirmation from the Board of Directors to provide to the auditors the agreements between SIBL and SFGC, SGC, STC, and SGAL. This item will be followed up on the next quarterly audit.

OPERATING EXPENSES

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 3,097,393	$ 3,116,045
Expressed in detail:		
Salaries and Other Staff Cost	$ 627,492	$ 656,792
Office & Other General Expenses	427,762	454,943
Insurance Expense	459,573	389,250
Rent	264,750	313,369
Professional Fees	226,488	272,298
Depreciation	229,012	215,730
Travel and Accommodations	151,094	183,970
Telephone and Telex	163,508	155,046
Bank Charges	144,084	137,958
Advertising and Promotion	207,940	106,974
Subscriptions and Donations	53,177	81,931
Electricity & Water	18,775	79,355
Repairs and Maintenance	71,688	50,509
Licenses and Permits	7,050	17,920
Directors Emoluments	45,000	0
Total Operating Expenses	$ 3,097,393	$ 3,116,045

Operating Expenses for the first quarter 2006 increased slightly by $59,057, and increase of 1.91%. We verified all expense accounts on the income statement. They were correctly applied and posted to the financial statements. Overall, expenses are in good order.

Please see attachments AA.2, AA.4

8. Observation

We reviewed the rent expense and observed that the Bank makes payments to Stanford Development Company Limited (SDCL) for the use of the Bank premises for three leases referred to as the old lease, the new lease, and the STC portion. We requested copies of the lease agreements in order to make certain that the Bank rent expenses paid agreed with the terms of the agreements. The Bank was only able to provide a copy of the agreement known as the new lease. This agreement between SIBL and SDCL dated April 1, 2002 is for a term of twenty years for a yearly rent of $848,000.

The Bank did not have a copy of the agreement known as the old lease. The Bank did provide us with an amortization schedule that shows based on a payment made to SDCL for $6,500,000 in December 1998; the monthly amortization deduction for SIBL is $41,666.67 monthly through April 2002. After April 2002, when the new lease agreement was signed, the monthly amortization was reduced to $20,313.

The Bank also did not have a copy of the STC portion lease agreement. This agreement is for the area in the building that was formerly occupied by STCL, but is now occupied by the Bank.

Recommendation

We recommend that Bank obtain and maintain copies of lease agreements for which lease or rental payments are made. We also recommend that the Bank obtain and maintain in a convenient place supporting documents related to prepayments for which amortization over future periods. This will allow the Bank to demonstrate that accounts are accurate and financial statements are supported with the requisite documentation.

9. Observation

We observed that Bank policy states that: "All checks require at least two signatures with the exception of the single signatory bank account. At least one of the dual signatures should be someone independent from the person who approves the transaction for payment." The accounting manager signs checks for payment of items in which he has also approved the item for payment. This represents a lack of proper segregation of duties. The ideal situation would be that both signatures are from individuals independent of the person that approves the transaction. If possible, accounting staff should not sign the checks.

Recommendation

We recommend that the Bank implement the practice to obtain both signatures from individuals independent of the individual who approved the transaction for payment.

OPERATING PROFIT

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 19,680,430	$ 4,415,132
Net Income	$ 22,777,823	$ 7,531,305
Operating Expenses	(3,097,393)	(3,116,046)
Operating Profit	$ 19,680,430	$ 4,415,132

Operating Profit for the quarter ending March 31, 2006 fell to $4,415,132 from $19,681,430 for the quarter ending December 31, 2005. This was a decrease of 77.57%.

Please see attachments AA.2, AA.4

CONTINGENCIES

Total balance on account	Dec 31st, 2005	Mar 31st, 2006
	$ 27,815,441	$ 34,044,233

We observed that contingent liabilities increased 22.39%. Contingent liabilities are letters of credit that have been opened for the benefit of the Bank customers.

Please see attachments AA.2, AA.4

All contents of this report were discussed with Stanford International Bank Management and the accounting department on location. Refer to responses within the context of this report for their confirmation.

Should you have any additional questions or comments please so advise.

Regards,

Stanford Financial Group
Internal Audit Department